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DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 97-0145 ITC
Adjusted Gross Income Tax — Throwback Sales
For Tax Periods: 1994 and 1995

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ISSUE

I. Adjusted Gross Income Tax — Throwback Sales

Authority: IC 6-3-2-2
45 IAC 3.1-1-64
Public Law 86-272 (15 U.S.C.A §381-385)

Taxpayer protests the inclusion of sales to Illinois in its Indiana apportionment sales factor.

STATEMENT OF FACTS

Taxpayer, an Indiana corporation, is a wholly owned subsidiary of an Illinois corporation. For the audit period in question, taxpayer filed its Indiana Corporate Income Tax Return (IT-20) as a separate entity. For Illinois and federal income tax purposes, taxpayer filed as part of its parent's combined/unitary group.

Taxpayer operates a foundry in the state of Indiana. In its normal course of business, taxpayer manufactures and sells an array of iron castings - castings made according to its industrial customers' specifications. For adjusted gross income tax purposes, taxpayer apportioned most of its sales to Indiana. Taxpayer, however, did not report sales made to its Illinois customers on its Indiana Corporate Income Tax Returns (IT-20). Taxpayer apportioned those sales to Illinois. Upon audit, the Illinois sales were re-characterized as "throwback sales" and included in taxpayer's Indiana apportionment factor.

I. Adjusted Gross Income Tax — Throwback Sales

DISCUSSION

Taxpayer protests Audit's characterization of taxpayer's sales to Illinois as throwback sales.

Sales made by Indiana corporations to out-of-state purchasers must be apportioned, as income, to Indiana, if the state in which the purchaser resides is without legal authority to claim such income as its own. (See IC 6-3-2-2(e) and 45 IAC 3.1-1-64.) Specifically, if interstate sales are "taxable in another state" - i.e., the state of the purchaser - the sales are not includible in the numerator of the Indiana sales factor. Such sales are defined as throwback sales.

According to IC 6-3-2-2(n):

> For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if:
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> (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or
>
> (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Indiana's regulatory language further defines "taxable in another state." 45 IAC 3.1-1-64 states in part:

> A corporation is "taxable in another state" under the Act when such state has jurisdiction to subject it [the corporation] to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385.

Therefore, if the income derived from sales to Illinois are taxable in Illinois, then Indiana can not require taxpayer to "throwback" these sales to Indiana.

Audit contends that taxpayer's sales to its Illinois' customers should have been included in the numerator of the Indiana sales factor. In reaching this conclusion, Audit determined that taxpayer had not established nexus with Illinois under the minimum standards of Public Law 86-272. In other words, taxpayer did not have sufficient contacts with Illinois to require taxpayer to apportion any sales to Illinois. Since taxpayer was not subject to Illinois income tax, consistent with 45 IAC 3.1-1-64, Audit concluded that taxpayer must "throwback" these sales to Indiana.

Taxpayer, in response, argues that under Illinois law, taxpayer was required to be included in its parent's Illinois combined/unitary group. Taxpayer notes that under Illinois law, common

ownership and "strong centralized management" are strong indicia of the existence of a unitary business relationship. Taxpayer emphasizes that both attributes accurately reflect taxpayer's relationship with its parent. Since taxpayer must be included in its parent's Illinois unitary group, taxpayer reasons that these sales are taxable by Illinois. Therefore, consistent with 45 IAC 3.1-1-64, taxpayer contends that sales to its Illinois' customers are "taxable in another state" and must be apportioned to Illinois, and not to Indiana.

As 45 IAC 3.1-1-64 informs, "[j]urisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385." Under the minimum standards of Public Law 86-272, taxpayer's activities do not provide Illinois with sufficient contacts for income apportionment purposes. Taxpayer has neither advanced arguments nor offered evidence to suggest otherwise. Rather, taxpayer has argued that because it is a member of its parent's Illinois combined/unitary group, it is required to apportion its Illinois sales to Illinois. Such reasoning is flawed. The taxpayer filing in Illinois is not the same taxpayer that is filing in Indiana.

Taxpayer's decision to file on a combined/unitary basis does not transform income previously immune from taxation (by Illinois) - because of the proscriptions of Public Law 86-272 - into taxable income. In this case, the decision (or requirement) to file as a member of an Illinois combined/unitary group does not affect Indiana apportionment determinations. Just as a state may not circumvent the minimum standards of Public Law 86-272 by "acquiring" nexus indirectly through its relationship with other members of taxpayer's unitary group, a taxpayer may not seek shelter in the tax laws of a state in which it does not have sufficient contacts.

Illinois law also supports this conclusion.

> (A) Example:
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> (i) Corporations A, B, C constitute a unitary business group. All three corporations are eligible to make the election under IITA Section 502(f). Under PL 86-272, Corporations A and B are taxable in Illinois, but Corporation C is not.
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> (ii) Based on these facts, if the election to be treated as one taxpayer is made, the combined Illinois sales factor must be determined by dividing the group's combined Illinois sales (excluding any sales of Corporation C shipped to purchasers in Illinois) by the total combined sales of the group everywhere.

(See 86 Ill. Adm. Sec. 100.5270 (b)(1)(Ex. A)).

The Department concludes, therefore, that taxpayer was not subject to taxation in Illinois. Consequently, the throwback of sales shipped into Illinois from Indiana was proper.

FINDING

Taxpayer’s protest is denied.